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IN THIS ISSUE:

Japan's Economy In 1987 1

Yen Settles Down 4

Japan Burdened By Taxes 5

Cabinet Maps Policies At Diet Opening 7

Japan Retaliates Against North Korea 8

Council On Competitiveness
Looks At Presidential Candidates 9

Notes: Trade Bill 11

Japan's Economy In 1987

If economic officials in Tokyo had known at the beginning of 1987 what was coming, they might have been very concerned. How could the economy, still reeling from the appreciation of the yen in 1986, survive a further 30 percent increase in 1987? Add the stock market crashes around the world in late October, and they would have had real reason to worry.

So it must have come as a surprise that the economy not only survived these unanticipated problems but even exceeded the forecasts issued before they occurred. More than one analyst has compared the economy's resilience in the face of these external disturbances to its behavior during the two oil shocks. This time, while the soaring yen did pull the economy down, increasing domestic demand turned out to be more important. The final figures are not in but inflation-adjusted growth is almost certain to exceed the government's original 3.5 percent forecast for fiscal year 1987, ending March 31. It is now forecasting 3.7 percent real growth for FY 1987.

The statistics for calendar 1987 now being released paint a remarkably clear picture of healthy growth led by increasing domestic demand. Mining and manufacturing production, for example, after getting off to a weak start, was strong throughout the second half of the year (see Table 1). Increases in production seem to be chasing increases in demand as inventories have declined on a year-to-year basis every month since May 1986. While initially the changes may have reflected caution about the economy's prospects, toward the end of 1987 inventory depletion accelerated as the economy's expansion appeared to pick up speed.

Table 1: Mining and Manufacturing Index
(percentage change from year-earlier period)

	Production	Inventories
1983	3.6%	-5.1%
1984	11.1	2.9
1985	4.6	8.6
1986	-0.4	-0.1
1987 (preliminary)	4.0	n.a.
1987		
January	0.5	-2.1
February	-0.1	-3.6
March	1.6	-4.7
April	0.3	-2.9
May	-0.8	-4.6
June	3.0	-5.0
July	4.1	-6.4
August	5.0	-5.7
September	5.3	-5.8
October	9.0	-4.9
November	10.5	-4.7
December (preliminary)	8.6	-5.2

Source: Ministry of International Trade and Industry

One might expect that the healthy growth in output would create pressure somewhere in the economy, but so far that has not happened. While the Bank of Japan continues to worry about inflation, central bankers in other countries may envy its situation. In 1987, prices showed remarkable stability, with wholesale prices falling 3.7 percent, their fifth straight yearly drop. Consumer prices rose 0.1 percent, the lowest rate of increase in 29 years. The Management and Coordination Agency attributed the performance to the yen's appreciation and lower crude oil prices. For example, food prices, which are heavily dependent on import prices, declined 0.9 percent.

The job situation also generally improved during the year, although the average unemployment rate equaled 1986's postwar high of 2.8 percent. After hitting a peak of 3.3 percent in May, the jobless rate generally declined for

the rest of the year, standing at a seasonally adjusted 2.6 percent in December. Many analysts caution against comparing unemployment rates in Japan with those in other countries because the measurement techniques and macroeconomic interpretations are different.

The pattern of change in the labor market in Japan is confirmed by other data: the ratio of job offers to job seekers has shown a steady improvement since November 1986 on a seasonally adjusted basis. For 1987 it stood at 0.70, an improvement from 0.62 the previous year, and is now at the highest level in 13 years. Hours of overtime in manufacturing, a closely watched indicator of labor demand, ended 21 consecutive months of year-to-year declines in May and have since increased for six straight months. The figure is now higher than it was before the decline began in mid-1985.

Increasing private and public demand was clearly a major reason for the year's growth. Spurred by lower interest rates, housing was particularly strong, with 1.7 million starts, a jump of 22.7 percent. There were some indications at yearend that growth was slowing, although the December figure was still comfortably ahead of the year-earlier number. Government spending also increased sharply during the year.

Trade did not contribute to the economy's strong performance, although the numbers may suggest otherwise. As Table 2 shows, the trade (both exports and imports valued f.o.b.) and current account surpluses in dollar terms showed a slight increase, suggesting that foreign criticism of Japan's trade imbalance is unlikely to diminish. Expressed in yen, the two surpluses showed a sharp decline during 1987, meaning changes in foreign trade by itself would have led to negative growth during the year. The difference, of course, is attributable to the appreciating yen: exports, which were down in yen terms, soared enough in dollar terms to overwhelm the increase in imports, which were up sharply in both dollar and yen terms.

Table 2: Balance of Payments

	Millions of dollars	Billions of yen
Trade		
1986	$92,827	Y15,341
1987	96,464	13,914
Current Account		
1986	85,845	14,179
1987	86,688	12,496
Long-term Capital		
1986	-131,461	-21,741
1987	-137,127	-19,892

Source: Bank of Japan

While in the last half of the year all measures of trade and the current account generally showed a declining surplus, there was a year-to-year increase in the dollar-denominated current account surplus for December. This rise renewed fears that the surpluses might prove intractable.

Douglas Ostrom

Yen Settles Down

Suddenly all is quiet in the currency markets. After wild gyrations in November and December, both the yen and dollar were remarkably stable during January. In the last week of the month, for example, the range between the dollar's high and low value on the Tokyo foreign exchange market was only half a yen. The dollar closed at 127.18 yen and averaged 127.66 yen, down from 128.35 yen in December. The markets more or less shrugged off both favorable U.S. trade statistics and somewhat disappointing Japanese figures.

The new tranquility seems to suit the Bank of Japan. In a Tokyo speech the governor of the bank, Satoshi Sumita, argued for exchange rate stability as a policy objective, pointing out that exchange rate variations can affect prices, interest rates and the stock market. By contrast many in the Reagan administration believe that stabilizing exchange rates is impractical because picking the appropriate rate is difficult or impossible and, once chosen, will soon change. Such officials would argue that monetary and fiscal policies influence the exchange rate through market forces. In this view the exchange rate is an effect rather than a cause of changes elsewhere in the economy.

For the next few months at least, a major factor will be the attitudes of Japanese and other investors concerning the market for U.S. securities. Last year private Japanese investors were net buyers of $73 billion worth of U.S. and other foreign bonds, while foreigners bought about $7 billion net in Japanese bonds. While foreign purchasers profited as the yen appreciated, Japanese who invested overseas lost heavily.

The BOJ points to interest rates on comparable U.S. long-term securities that are 4.5 percentage points higher than Japan's as evidence that Japanese investors should be more than willing to invest here. Of course, should the dollar fall dramatically, that difference would be far too small to compensate for the exchange rate loss. On the other hand, a stable currency can be self-reinforcing: if the dollar is expected to stay where it is, dollar investments are attractive, which in turn keeps the dollar from falling.

Investors will be making their decisions at a time when interest rates may be heading lower in both countries. In late January a key Japanese rate, the long-term prime, was lowered by 0.2 percentage point to 5.5 percent. The money supply continues to grow rapidly, with the most widely followed measure, M2 + CDs, up by 11.5 percent in December on a year-to-year basis, putting downward pressure on short-term interest rates.

In the United States, rates fell during January and speculation continues that the Federal Reserve Board will expand the money supply and reduce interest rates further to head off an election year recession. While current

Japanese monetary policy makes this option safer than otherwise, the Fed still runs the risk that significantly looser money could quickly reduce the attractions of investing here and send the dollar down again.

Douglas Ostrom

Japan Burdened By Taxes

Debate over tax reform is heating up as the government prepares to submit spending and revenue plans for fiscal 1988. Prime Minister Noboru Takeshita and Finance Minister Kiichi Miyazawa are busily building a national consensus in favor of a new major indirect tax, while opposition parties are working to defeat this proposal. According to Ministry of Finance projections, the deficit will widen in FY 1989 unless spending is cut or revenue raised. The short-term outlook is rosy, however, as a resurgent economy is generating solid revenue growth.

As the Table shows, total fiscal 1988 revenues are expected to increase 5.3 percent to just over Y46.4 trillion ($371.3 billion at Y125=$1.00), thanks to a big jump in special account revenues (energy and excise taxes earmarked for local governments or the Fiscal Investment and Loan Program), and moderate growth in direct and indirect tax receipts. Of concern to MOF is the continued reliance on direct taxes. Personal, corporate and inheritance taxes will provide 72.2 percent of total revenues in fiscal 1988, up from FY 1987's 71.9 percent level. After reaching the 74 percent mark in FY 1974, the ratio fell to the 60 percent range until the 1980s, when it returned to and stayed above the 70 percent level. In contrast, indirect taxes will provide 27.8 percent of total revenues in FY 1988 compared with the previous year's 28.1 percent.

The fact that personal income tax receipts are expected to rise nearly 8 percent while corporate tax revenues expand less than 2 percent is also a warning signal to policymakers. Consumer spending probably will be dampened if income tax growth is greater than overall economic growth, putting pressure on plans to restructure the economy to rely on domestic demand. One component, the jump in inheritance tax revenues, can be laid to the sharp increase in land and stock prices, and is a one-time phenomenon, according to MOF officials. MOF also expects stock market activity to decline, as indicated by the 5.8 percent drop in expected transaction tax revenues.

In its annual report, MOF projects that the government will need to borrow an additional Y4.9 trillion ($39.2 billion) in fiscal 1989 and Y5.5 trillion ($44 billion) in fiscal 1990 if government subsidies to farmers and others are not slashed. MOF continues to embrace the view that the budget should be balanced by FY 1990, a position echoed by the prime minister. Officials have called for sharp cuts in farm and other subsidies, as well as in education and social security programs.

To avoid these cuts, the administration is urging comprehensive tax reform. Although no government official specifically mentioned a value-added tax in speaking to the Diet (see following article), the tax policy councils of the Finance Ministry and the Liberal Democratic Party are said to favor a 3 percent VAT. Former prime minister Yasuhiro Nakasone was forced to withdraw a 5 percent VAT proposal last year in the face of a withering public outcry, and the

opposition parties have condemned any new indirect tax and vowed to whip up public sentiment if the government introduces such legislation. Mr. Takeshita is trying to compromise, offering to cut income taxes in exchange for the introduction of a VAT. The idea is not likely to calm the opposition, and the prime minister will be hard put to advance his fiscal ideas during the current Diet session.

Jon Choy

Tax and Stamp Revenues, FY 1987-FY 1988

(in billions of yen and percentage change)

	FY 1987		FY 1988	
	Initial	Revised	Initial	Change*
General Account Budget				
Direct taxes	Y29,819	Y31,703	Y33,488	5.6%
Personal income tax	16,482	16,188	17,444	7.8
Withheld	12,878	12,303	13,266	7.8
Self-declared	3,604	3,885	4,178	7.5
Corporate income tax	11,824	13,722	13,931	1.5
Inheritance tax	1,513	1,793	2,113	17.8
Indirect taxes	11,375	11,384	11,602	1.9
Liquor tax	1,936	2,042	2,066	1.2
Tobacco tax	958	1,012	1,011	-0.1
Sugar tax	32	32	41	28.1
Gasoline tax	1,596	1,596	1,314	-17.7
Liquified petroleum gas tax	16	16	16	0.0
Aviation fuel tax	54	54	58	7.4
Petroleum tax	190	190	290	52.6
Commodity taxes	1,478	1,686	1,772	5.1
Playing card tax	1	1	1	0.0
Bourse tax	25	25	54	116.0
Securities transaction tax	1,179	1,766	1,663	-5.8
Travel tax	61	61	84	37.7
Admission tax	4	4	7	75.0
Vehicle tonnage tax	486	486	532	9.5
Customs duty	481	599	619	3.3
Tonnage tax	8	8	8	0.0
Stamp revenues	1,767	1,806	2,066	14.4
Sales tax**	1,103	--	--	n.a.
Total general account	41,194	43,087	45,090	4.6
Special Accounts				
Total	1,166.4	982.6	1,321.2	34.5
Total central government	42,360.4	44,069.6	46,411.2	5.3

*Initial FY 1988 compared to revised FY 1987.
**Proposed but never enacted.

Source: Ministry of Finance